CORPORATIONS

Liability of a Holding Company for Acts of Its Subsidiary.

A ninety-nine year lessee sub-leased the property to the Higbee Realty Company, a subsidiary of the Higbee Company. The subsidiary sub-leased the premises for ten years to the holding company. The first lessee assigned the lease to a trustee, and trust certificates were issued. After the ten year lease expired, the subsidiary defaulted in its payments on the ninety-nine year lease. Plaintiffs are the certificate holders and brought a class suit against the holding company for the recovery of taxes and rents, the trustee having become insolvent. A verdict was rendered in favor of the parent corporation. *North et al.* v. *The Higbee Co. et. al.* 131 Ohio St. 507, 3 N. E. (2d) 391, 6 Ohio Op. 166, Ohio Bar, July 20, 1936.

The court held that, notwithstanding the fact that the subsidiary was controlled through stock ownership and had the same officers and directors, the separate corporate entities of parent and subsidiary corporations would not be disregarded *unless the subsidiary was formed for the purpose of perpetrating a fraud.* The trial court found that there was no fraud in the fact that the parent corporation was in the mercantile business and organized the subsidiary to sever itself from its realty holdings. Three of the Justices in the principal case dissented on the ground that the subsidiary was a mere instrumentality and a fictional device to avoid liability. Under the rule of the majority opinion, it would be necessary for the subsidiary to be formed for the purpose of perpetrating a fraud, *and* actually used by the parent corporation to defraud the plaintiffs. The plaintiffs argued in their briefs, that the former Ohio cases do not preclude recovery if the subsidiary was originally organized for a bona fide purpose and was subsequently used to perpetrate a fraud or wrong. The cases cited in support of this proposition were: *State* v. *Standard Oil Co.,* 49 Ohio St. 137, 30 N.E. 279, 15 L.R.A. 145 (1892); *Cemetery Association* v. *Traction Co.,* 93 Ohio St. 161, 112 N.E. 596 (1915); *Auglaize Box Board Co.* v. *Hinton,* 100 Ohio St. 505, 126 N.E. 881 (1919); *The Damascus Mfg. Co.* v. *Union Trust Co.,* 119 Ohio St. 439, 164 N.E. 530, 28 Ohio L. Rep. 6, 6 Ohio L. Abs 710, (1928); *Old Ben Coal Corp.* v. *Universal Coal Co.,* 28 Ohio N.P. (N. S.) 563 (1931).

As a general rule, a holding company is not liable for the acts of its subsidiaries. *Stone* v. *Cleveland C. C. & St. L. R. Co.,* 202 N.Y. 352,

95 N.E. 816, 35 L.R.A. (N. S.) 770 (1911); *Majestic Co.*, v. *Orpheum Circuit*, 21 Fed. (2d) 720 (1927); *First National Bank* v. *Walton*, 146 Wash. 367, 262 Pac. 984 (1928); *Harlon Pub. Serv. Co.*, v. *Eastern Constr. Co.*, 254 Ky. 135, 71 S. W. (2d) 24 (1934). In formulating a basis for predicating liability the courts have used various theories. Courts have variously used the "agency" and "instrumentality" theories, the latter being referred to in many cases as the "identity," "alter ego," "adjunct" or "conduit" theories. The latter theory is to the effect that the "parent corporation will be responsible for the obligations of its subsidiary when its control has been exercised to such a degree that the subsidiary has become its mere instrumentality." Powell, Parent and Subsidiary Corporations (1931), p. 8. The agency theory is predicated upon the application of the general principles of agency, whereas the instrumentality doctrine is somewhat broader in its scope and application. Judge Cardozo in the case of *Berkey* v. *Third Avenue Railway Co.*, 244 N.Y. 84, 95, 155 N.E. 58 (1926), said, "Dominion may be so complete, interference so obtrusive, that by the general rules of agency the parent will be a principal and the subsidiary an agent. Where control is less than this, we are remitted to the tests of honesty and justice." Whereas the agency theory maintains the corporate separateness, the identity theory has the opposite effect, inasmuch as the latter theory wholly disregards the corporate identity of the subsidiary. Powell, *supra*, Chapter V. In the case of *Smith* v. *Knight & Son*, 211 Ky. 111, 277 S.W. 290 (1925), the court said that it must appear that the company is the business conduit or alter ego of the other, before there can be liability on this theory. Thomas, Theories Used in Holding the Parent Liable for the Acts and Obligations of the Subsidiary Corporation, 24 Cal. L. Rev. 447 (1936).

It then becomes a question of determining what circumstances will render the subsidiary an "instrumentality". Control through stock ownership alone, does not make the parent corporation liable for the acts of its subsidiary. *General Motors Corp.* v. *Moffett*, 27 Ohio App. 219, 6 Ohio L. Rep. 367 (1927); *Majestic Co.* v. *Orpheum Circuit, supra; Industrial Research Corp.* v. *General Motors Corp.* et al, 29 Fed. (2d) 623 (1928); *U. S.* v. *Reading*, 253 U.S. 26, 40 Sup. Ct. 425, 64 L. Ed. 760 (1920); *The Continental & C. T. & S. Bank* v. *Garden City Co.*, 123 Kans. 659 (1927); *McDermott* v. *Oil Burner Sales Corp.* 266 Ill. App. 115 (1932); *Harlan Pub. Serv. Co.* v. *Eastern Constr. Co., supra; Cannon Mfg. Co.* v. *Cudahy Packing Co.*, 267 U.S. 333, 45 Sup. Ct. 250, 69 L. Ed. 634 (1925); *Bethlehem Steel Co.* v. *Raymond Concrete Pile Co.*, 141 Ind. 67, 118 Atl. 279 (1922);

Ballantine, Parent and Subsidiary Corporations, 14 Cal. L.R. 12 (1925). The additional factor of common directors or officers has been held not to be controlling, although in many cases it is an important factor. *Pagel, Horton & Co.* v. *Harmon Paper Co.*, 258 N.Y.S. 168 (1932); *Pittsburgh & Buffalo Co.* v. *Duncan*, 232 Fed. 584 (1916); *Majestic Co.* v. *Orpheum Circuit, supra; Owl Fumigating Corp.* v. *California Cyanide Co.*, 24 Fed. (2d) 718 (1928); *Berkey* v. *Third Avenue Railway Co., supra.* The mere addition to the foregoing elements of one or more factors may be sufficient to render the subsidiary a mere "instrumentality." Where the parent corporation furnished capital to finance the subsidiary it was held not to be sufficient control, *Berkey* v. *Third Avenue Railway Co., supra.* But in the following cases the parent was held liable; parent corporation formed subsidiary and subscribed to its stock, *The Willem Van Driel Sr.*, 252 Fed. 35 (1918); subsidiary was a mere division or department of the parent corporation and dealt only with the parent, *Westinghouse Electric & Mfg. Co.* v. *Allis-Chalmers Co.*, 176 Fed. 362 (1910); parent corporation used property of subsidiary as its own, *Dobbins* v. *Pratt Chuck Co.*, 242 N.Y. 106, 151 N.E. 146 (1926); failure to keep separate books, *Southern Pacific Co.* v. *Lowe*, 247 U.S. 330, 38 Sup. Ct. 540, 62 L. Ed. 1142 (1918). The following fact situations are important elements to be considered: the paying of salaries and losses of subsidiary by the parent; the directing of officers of the subsidiary by those of the parent; where the subsidiary has a grossly inadequate capital; where formal legal requirements of the subsidiary are not observed. Powell, *Supra*, p. 9; Stevens on Corporations (1936), p. 80; Douglas and Shanks, Insulation from Liability Through Subsidiary Corporations, 39 Yale L.J. 193 (1929), at 195 ft. note, writers list some eighteen factors that may be controlling; see also, *Kingston Dry Dock Co.* v. *Lake Champlain Transp. Co.*, 31 Fed. (2d) 265 (1929); *Lowendahl* v. *Baltimore & O. R. Co.*, 287 N.Y.S. 62 (1926); *U. S.* v. *Reading, supra;* Wormser, Piercing the Veil of Corporate Entity, 12 Col. L.R. 496 (1912). Yost, Liability of a Parent Corporation for the Debts of its Subsidiary, 21 St. Louis L. Rev. 234, 240 (1936).

Assuming that there are sufficient facts to warrant the conclusion that the subsidiary is an agent or the instrumentality of the parent, is there a further necessity of finding fraud in the formation of the subsidiary or in its use? Many courts have predicated liability on agency or instrumentality concepts, while some courts have considered fraud essential before there is a sufficient basis for liability. The corporate entity will be disregarded when necessary to prevent or circumvent fraud, *or*

when one corporation is merely the instrumentality of the other. *Gillis* v. *Jenkins Petroleum Process Co.*, 84 Fed (2d) 74 (1936); *McDermott* v. *Oil Burner Sales Corp., supra; Pacific American Gasoline Co.* v. *Miller*, 76 S.W. (2d) 833 (Texas) at 851 (1934); *State* v. *Standard Oil Co., supra; Parkside Cemetery Assn.* v. *Traction Co., supra*, at 173, 174. Either control or fraud is sufficient basis to disregard the corporate entity. *In re Watertown Paper Co.*, 169 Fed. 252 (1909). "There is a consistent determination by courts to look through corporate forms, and this disposition is shown with increasing firmness as the interests of justice require." *Auglaize Box Board Co.* v. *Hinton, supra*, at 518. The identity theory has been used where parent corporation uses the subsidiary to avoid liability. *Nashville C. & St. L. Ry.* v. *Faris*, 60 S.W. (2d) 425 (Tenn. 1933). Where the subsidiary is used to evade a statute or defeat public convenience, the separateness of the entities will be denied. Stevens on Corporations, *supra*, at page 81. Examples are: attempt to do an act which parent could not lawfully do, *U. S.* v. *Reading, supra;* illegal combination in restraint of trade, *Northern Securities Co.* v. *U. S.*, 193 U.S. 197, 24 Sup. Ct. 436, 48 L. Ed. 679 (1904); to defeat bona fide creditors, *In re Marcella Cotton Mills*, 8 Fed. (2d) 522 (1925); See also: *Pacific American Gasoline Co.* v. *Miller, supra*, at 851; *Detroit Motor Appliance Co.* v. *General Motors Corp.*, 5 Fed. Supp. 27 (1933); Fletcher, Cyclopedia Corporations (perm. Ed.) 1931, Vol. I, pp. 154-176. Two courts have applied a rather strict rule. They held that there must be sufficient control *and* the element of fraud to predicate liability. *Continental Securities & Investment Co.* v. *Rawson*, 208 Cal. 288, 280 Pac. 954 (1929); *Briggs & Co.* v. *Harper Clay Products Co.*, 150 Wash. 235, 272 Pac. 962 (1928).

In many cases, recovery against the parent corporation has been denied because the complainant has not been injured as a result of the parent corporation's undue control, or because the complainant has an adequate remedy without resort to the parent corporation. The control and breach of duty must proximately cause the injury or loss complained of by the plaintiffs. *Lowendahl* v. *Baltimore & O. R. Co., supra; Majestic Co.* v. *Orpheum Circuit, supra.* Courts have permitted recovery on the doctrine of estoppel, where there has been a misrepresentation by the parent corporation in holding itself out as being behind the subsidiary. *Platt* v. *Bradner Co.*, 131 Wash. 573, 230 Pac. 633 (1924). However, there can be no estoppel unless the complainant relied upon and was misled by the representations of the parent corporation. *Pagel, Horton & Co.* v. *Harmon Paper Co., supra;* Powell, *supra*, Chapter

IV, par. 15; The Disregard of the Corporate Fiction, Maurice Wormser (1929); 43 Harv. L. Rev. 1154. It becomes readily apparent from the foregoing discussion that one cannot answer the question as to when the corporate entity will be disregarded in a particular case. Justice Cardozo in the Berkey case, *supra*, said, the whole subject is "still enveloped in the mists of metaphor". Each case must be decided on its own facts and must be regarded as "*sui generis.*" *Industrial Research Corp.* v. *General Motors Corp.*, *supra*; 4 Minn. L. Rev. 219, 227. See generally, Latty, Subsidiaries and Affiliated Corporations (1936); reviewed by Wormser in 31 Ill. L. Rev. 700 (1937).

The rule in the principal case to the effect that the separate corporate entities of the parent and subsidiary corporations will not be disregarded, unless the subsidiary was formed for the purpose of prepetrating a fraud, is both fair and practical if the court means to limit the rule to the instrumentality concept of liability. "There is in many cases much loose talk about 'ignoring the corporate fiction' and 'looking at the substance rather than the form.' But the corporate capacity is a legal fact, not a fiction." Ballantine, *supra*, at page 20. However, if the Supreme Court means to preclude liability on the basis of agency, it is unfortunate. The doctrine of agency is equally applicable in parent-subsidiary relationships as it is in partnership or other personal relationships. It has been said that "problems of responsibility for fraud or for the acts of a corporation used as an agent are to be solved not by 'disregarding' the corporate personality, but by the application of the usual principles of liability for the acts of other persons or for collusion with them." Ballantine, *supra*, at page 20.

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DEEDS

BONA FIDE PURCHASER UNDER ESCROW DEED

The plaintiff made a warranty deed, naming her daughter as grantee. She intended to give it to her (plaintiff's) son, who was to hold it until her death, on which event it was to be given to grantee. The grantee's husband wrongfully got possession of the deed and had it recorded. The grantee then obtained a loan from the Ohio Valley Bank, giving the latter her promissory notes. In making the loan the bank relied on her record title to the land, but it did not take a mortgage. The defendant, in charge of liquidating the bank, procured judgment on the notes and levied execution against the property. The